GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:4017
ANSWERED ON:09.12.2016
High Frequency Trading Companies
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Will the Minister of FINANCE be pleased to state:

(a) whether SEBI was alerted by a whistle blower of unethical practices followed by High Frequency Trading (HFT) companies on the National Stock Exchange (NSE) and if so, the details thereof;

(b) whether this manipulative practice gives certain vested traders market information ahead of the rest of the market to leverage the millisecond advantage available under HFT and if so, the details thereof;

(c) whether the NSE had refused to part with information on its operations and functioning under the RTI Act in recent past;

(d) if so, the details thereof; and

(e) the steps taken by the SEBI to monitor and check such malpractices in the NSE?

Answer

MINISTER OF STATE IN THE MINISTRY OF FINANCE
(SHRI ARJUN RAM MEGHWAL)

(a): Yes Madam. The Securities and Exchange Board of India (SEBI) has informed that it received three letters dated January 2015, 10th August 2015 and 28th October 2015 from a whistleblower making the following allegations with regard to the co-location facility of the National Stock Exchange (NSE):

i. Preferential access to data dissemination servers was given to few stock brokers
ii. NSE allowed non-empanelled internet service provider (ISP) to lay fiber in its premises for few stock brokers, and
iii. Certain NSE officials colluded with the stock broker(s) in the matter.

(b): SEBI had constituted an Expert Committee under the guidance of its Technical Advisory Committee (TAC) to examine the allegations made by the complainant. The major observations / findings of the Expert Committee following examination of the same were as follows:

i. The architecture of NSE with respect to dissemination of Tick-by-Tick (TBT) through Transmission Control Protocol / Internet Protocol (TCP/IP) was prone to manipulation / market abuse.

ii. Preferential access was given to stock broker(s) wherein it was possible for a stock broker to log in to multiple dissemination servers through multiple Internet Protocols (IPs) assigned to him. It was also possible for a single member to have multiple logins to a single dissemination server through multiple IPs assigned to it. It was observed that stock broker(s) had a substantial advantage by logging in first or even second and third.

iii. NSE followed a static mapping process for allocating members' IPs to dissemination servers due to which few brokers were able to log on to the fastest dissemination servers. NSE had no load balancers for members connecting to the TCP/IP-based TBT Dissemination Servers. Further, NSE also did not have randomizers for randomizing member positions on the Disseminating Servers/ Ports.

(c) and (d): National Stock Exchange (NSE) has informed that the applicability of the Right to Information (RTI) Act, 2005 to NSE was affirmed by the Central Information Commission and the Single Bench of the Delhi High Court. However, the division bench of the Hon'ble Delhi High Court, vide its Order dated May 4, 2010, stayed the judgment of the single judge bench of the Hon'ble Delhi High Court which had interpreted NSE as a "public authority" under the RTI Act. Hence, as on date, NSE does not come under the purview of the RTI Act. NSE has further informed that it had received only one application under the RTI Act in the last one year seeking information on its operations and functioning. The said application from Shri. Arun Kumar Agarwal sought information on issues likes trading details of price manipulation and insider trading in certain securities, applicability of RTI Act, defamation suit, initial public offering by NSE etc. Notwithstanding the stay order of the Division Bench of the Delhi High Court, the letter was responded to by NSE with all information available in the public domain on November 11, 2016

(e): SEBI has informed that the TCP-IP based TBT data broadcast at NSE has been discontinued with effect from 3rd December, 2016. Further, as an ongoing endeavour to consistently upgrade and strengthen the systems and practices at stock exchanges in line with technological advancements, SEBI has issued regulatory guidelines in the form of Circulars from time to time.

In the matter of co-location, SEBI, vide Circular dated 13th May, 2015, has advised stock exchanges to ensure fair and equitable access to the co-location facility. Further, vide Circular dated 1st December, 2016, SEBI has, inter alia, directed the stock exchanges to further strengthen the co-location framework in order to ensure fair and equitable access, in the following manner:

i. To allow direct connectivity between co-location facility of one recognised stock exchange and the co-location facility of other recognized stock exchanges.

ii. To allow direct connectivity between the servers of a stock broker placed in the co-location facility of a recognized stock exchange and servers of the same stock broker placed in the co-location facility of a different recognized stock exchange.

Further, the co-location services provided through third parties and local area network (LAN) based connectivity to stock brokers have been brought under the ambit of regulatory framework for colocation facility.

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